91-508

Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

FAHNESTOCK & CO., INC.,

Petitioner,

vs.

JOSEPH J. WALTMAN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

1. In a regulated industry, such as the securities industry, are responses to "YES" or "NO" questions on the mandated filing of a prescribed form protected by an absolute or qualified privilege?

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INTRODUCTION

In this proceeding, Petitioner Fahnestock & Co., Inc. ("Fahnestock") brings before this Court a question which strikes at the very heart of the regulatory framework governing the securities industry. On rather simple and straightforward facts, Fahnestock urges this Court to clarify the law with respect to whether, in regulated industries, pertinent responses on filings mandated by statute are protected by an absolute or qualified privilege. This issue is of particular concern to the securities industry, where brokerage firms, such as Fahnestock, are required by statute, to continually make a myriad of filings with respect to their business and employees.

The instant case arises in the limited context of the filings brokerage

firms are required to make by the National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE") to disclose the termination of employment of any registered representative and the reasons for that termination. Brought before the federal courts in a diversity action stemming from an NYSE arbitration, the only issue before this Court is whether brokerage firms are protected by an absolute or qualified privilege in answering "YES" or "NO" questions on those prescribed forms. Petitioner Fahnestock contends that in finding such communications protected only by a qualified privilege, the Court below erred in its interpretation of applicable New York and federal law, disregarded the mandatory nature of such filings and failed to recognize the necessity of assuring candor on such

forms so as to maintain the integrity of the securities industry.

STATEMENT OF FACTS

Petitioner Fahnestock is a full-service stock brokerage firm. In or about March 1982, Fahnestock employed Respondent Joseph J. Waltman ("Waltman") as a registered representative. Fahnestock later requested that Waltman undertake to manage and build Fahnestock's insurance business and that he oversee the licensing of its salesmen and the sale of its insurance and annuity products. Waltman was employed by Fahnestock as an employee at will, there being no written employment agreement between Waltman and Fahnestock.

On or about December 12, 1988, Waltman's employment was terminated by Fahnestock. In connection with that termination, and as required by the

rules and regulations of the NYSE and the NASD, on or about January 4, 1989, Fahnestock filed a Uniform Termination Statement (a preprinted form prescribed by the NASD and more commonly referred to as "Form U-5") disclosing Waltman's termination.

Thereafter, Fahnestock discovered that its insurance files, including those relating to the insurance licensing of its registered representatives, were not to be found on Fahnestock's New York premises. Believing that Waltman possessed the missing files, Fahnestock contacted Waltman and requested that he return such files. Waltman, however, contended that the files belonged to him. Accordingly, a dispute arose over the ownership and possession of such files.

Failing in efforts to amicably resolve that dispute, on or about

January 27, 1989, Fahnestock filed a Statement of Claim with the Arbitration Department of the NYSE seeking the return of those files. That claim alleged solely that Waltman had wrongfully taken Fahnestock's files and sought an order directing their return. Shortly after the filing of its Statement of Claim, and again in accordance with the rules and regulations of the NYSE and NASD, Fahnestock also filed an Amended Form U-5, changing only one "NO" answer to a "YES" answer so as to truthfully disclose its dispute with Waltman.

More specifically, Question 15 on the Form U-5 states in full:

	Yes	No
15. Currently, or at termination, was the individual under internal review for fraud or wrongful taking of property, or violating investment-related statutes, regulations, rules or industry standards of conduct?...	☐	☐

While Fahnestock had checked the "NO" box on the Form U-5 filed at the time of Waltman's termination, on or about February 2, 1989, Fahnestock amended that filing by checking the "YES" box in response to Question 15. No other changes were made on the Form U-5 nor did Fahnestock add any gratuitous statements.

On or about March 20, 1989, Waltman served an answer and counterclaim in the NYSE arbitration. Waltman denied Fahnestock's allegations and asserted, by way of counterclaims, in pertinent part, his wrongful termination and that Fahnestock had defamed him in filing the Amended U-5.

On or about January 19, 1990, the arbitrators rendered a decision in favor of Waltman, and granted him compensatory and punitive damages (the "Award"). That Award found, in pertinent part,

that Fahnestock had defamed Waltman in the filing of the Amended Form U-5. It is that Award which is the subject of this proceeding.

PROCEDURAL HISTORY

Invoking diversity jurisdiction (Waltman being a resident of Pennsylvania and Fahnestock being a New York corporation) and pursuant to the Federal Arbitration Act, 9 U.S.C. 10, Fahnestock thereafter filed a petition with the United States District Court for the Southern District of New York seeking to vacate the Award to the extent it rendered an award for defamation and granted punitive damages. In substance, Fahnestock argued that the arbitrators had exceeded their powers and ignored the law in rendering an award for defamation based upon Fahnestock's filing of a post-termination form mandated by the

NASD. Fahnestock argued that relevant statements made by it in such a regulatory filing were protected by an absolute privilege. Fahnestock also contended that the arbitrators exceeded their powers in rendering an award for punitive damages.

Fahnestock's petition was granted in part and denied in part in an Opinion and Order of the United States District Court for the Southern District of New York (Judge Peter K. Leisure) dated August 22, 1990. (Appendix at A-23) Judge Leisure found that the arbitrators had exceeded their powers in rendering an award of punitive damages, and, accordingly, vacated that portion of the Award. However, Judge Leisure denied Fahnestock's application to vacate the award for defamation, holding that the privilege applicable to statements made on such required filings was not

absolute.

Fahnestock timely appealed from that portion of the District Court's decision which refused to vacate the award for defamation. Respondent Waltman cross-appealed from that portion of the decision which vacated the award of punitive damages. By decision dated June 10, 1991, the Second Circuit Court of Appeals affirmed the District Court's decision in all respects. (Appendix at A-1) Notwithstanding the Court's acknowledgment that the Form U-5 is a mandated filing, the Second Circuit found that Fahnestock's response on the Amended Form U-5 carried only a qualified and not an absolute privilege. This Petition seeks review of that portion of the Second Circuit's decision which failed to extend official immunity or an absolute privilege to responses on such prescribed filings.

ARGUMENT

THE REGULATORY FILING OF A PRESCRIBED FORM IS ABSOLUTELY PRIVILEGED

Whether viewed under applicable New York or federal law, or as a matter of public policy, there should be no question that responses to "YES" or "NO" inquiries on preprinted forms, prescribed and required to be filed by regulatory agencies, are absolutely privileged. Given the fact that Fahnestock was required under the federal regulatory scheme governing the securities industry to file an Amended U-5 to report its dispute with Waltman, that filing should not have been allowed to stand as the basis for an award for defamation.

(a) The Amended U-5 at issue was filed under legal compulsion.

The Securities and Exchange Act of 1934, 15 U.S.C. § 78a, et seq., (the

"Exchange Act") has established a comprehensive system for governing the securities industry. As part of that system, broad regulatory powers were delegated to the national securities exchanges. To assist in their investigative and enforcement functions, among the powers granted to each exchange is the authority to register brokers and obtain information about the qualifications of brokers and other employees of member firms. See, e.g., 15 U.S.C. §§ 78f(b), 78f(c).

To this end, the exchanges have adopted specific rules with respect to the employment, registration and termination of brokers. Focusing on the NYSE, with respect to the termination of employees, member firms are compelled to file a Uniform Termination Statement (Form U-5) disclosing the termination and explaining the reasons for such

termination. NYSE Rule 345.17 states in full:

> Termination of employment.--The discharge or termination of employment of any registered person together with the reasons thereof, shall be reported promptly, but in any event not later than thirty days following termination, to the Exchange on a U-5 Form.

It is also clear that the rules of the NASD require that amendments to such Form U-5's must be filed within thirty (30) days after a member organization learns that any information on the original filing was inaccurate or incomplete. Article IV Sections 3(a) and 3(b) of the NASD By-Laws, NASD Manual (CCH) Para. 1153, provide, in pertinent part:

> Sec. 3(a). Following the termination of the association with a member of a person who is registered with it, such member shall promptly, but in no event later than thirty (30) calendar days after such termination, give written notice to the Association on a form designated by the Board of Governors [U-5] of the termination of such

association....

> (b) The member shall notify the Association in writing by means of an amendment to the notice filed pursuant to paragraph (a) above in the event that the member learns of facts or circumstances causing any information set forth in said notice to become inaccurate or incomplete. Such amendment shall be filed with the Association...not later than thirty (30) calendar days after the member learns of the facts or circumstances giving rise to the amendment.

Although both the Second Circuit and the District Court implicitly acknowledged that the applicable NASD and NYSE rules and regulations required the filing of the Amended U-5, both Courts failed to find that statements made under such legal compulsion were protected by an absolute privilege. Such a holding was erroneous and must be reversed.

(b) As a matter of New York law, the mandated filing of prescribed forms is absolutely privileged.

There is no question that under New

York law statements made in quasi-judicial proceedings are protected by an absolute privilege. Weiner v. Weintraub, 22 N.Y.2d 330, 332; 292 N.Y.S.2d 667, 669 (1968). In that case, the Court of Appeals not only held that statements made in a quasi-judicial proceeding were absolutely privileged but extended that absolute privilege to communications prior to the proceeding, more specifically, letters of complaint to the Grievance Committee of the Association of the Bar of the City of New York. This same holding, in the guise of "absolute immunity," was reiterated by New York's highest court in Toker v. Pollack, 44 N.Y.2d 211, 222, 405 N.Y.S.2d 1, 6 (1978).

Admittedly, Youmans v. Smith, 153 N.Y. 214 (1897), sets forth a well recognized exception to the above-described general rule; that is,

that there will be no such privilege applicable to statements which are completely irrelevant to the judicial or quasi-judicial proceeding. Fahnestock also acknowledges that where such statements are not germane to the proceeding, the one making such statement may indeed be subject to a claim for defamation. See, e.g., Fleck v. E.F. Hutton, 891 F.2d 1047 (2d Cir. 1989). However, there can be no question as to the pertinence or relevance of the statement made by Fahnestock in the instant proceeding. Fahnestock merely checked a "YES" box to reveal its claim that Waltman had wrongfully taken its property. Fahnestock's response was directly pertinent to the information sought on the Form U-5.

Federal courts sitting in New York have similarly held that statements made

in the course of judicial or quasi-judicial proceedings are absolutely privileged as long as they are material and pertinent to the questions involved in the proceeding. Meyers v. Amerada Hess Corp., 647 F.Supp. 62 (S.D.N.Y. 1986). The Second Circuit has stated that same rule slightly differently, holding that such statements are absolutely privileged if it appears the affiant had probable cause to make the statement. King v. Hildebrandt, 331 F.2d 476 (2d Cir. 1964). Using either interpretation, there is no doubt that Fahnestock's "YES" answer should have been given absolute protection.

Lest there be any doubt that New York law extends an absolute privilege to statutorily mandated filings, the New York Appellate Division's recent decision in Herzfeld & Stern, Inc. v.

Beck, 1991 N.Y. App. Div. LEXIS 10662 (1st Dept. Aug. 1, 1991), has put any such doubt to rest. In Beck, a case admittedly decided after the Second Circuit's decision in the case at bar, the Appellate Division unequivocally held that statements made in Form U-5's were absolutely privileged. The Court reasoned that such statements were absolutely privileged because brokerage firms were compelled by law to file such forms with the NASD and NYSE. The Court went on to acknowledge that it is essential that such an absolute privilege be applied since it is those required filings which trigger the investigative and enforcement functions of the NASD and the applicable self-regulatory organizations.

Based upon Beck, supra, Fahnestock's statements made on Form U-5 are absolutely privileged and should have

been immune from a claim for defamation. Accordingly, the decision of the United States Court of Appeals for the Second Circuit holding that statements made on that Form U-5 carry only a qualified privilege must be reversed.

(c) As a filing made under legal compulsion, Form U-5's are absolutely privileged pursuant to the official immunity doctrine.

Similar to the result of any analysis under state law, it is well established under federal law that a required filing is absolutely privileged, and cannot serve as the predicate for a claim of defamation. Section 592A of the Restatement (Second) of Torts states this rule as follows:

> One who is required by law to publish defamatory matter is absolutely privileged to publish it.

Restatement (Second) of Torts § 592A (1977). Such absolute privilege applies

whenever the one who publishes the allegedly defamatory material acts under a legal compulsion to do so. In the instant case, Fahnestock was under such a legal compulsion to file the Amended U-5.

The holding in the Court below that such a filing is entitled to only a qualified privilege runs directly contrary to prior decisions extending official immunity, or an absolute privilege, to precisely such communications. In this regard, this Court has previously announced that there is an absolute privilege against defamation suits for discretionary statements made by either federal officials or private parties acting in a governmental capacity, where the allegedly defamatory statements were "within the outer perimeter of [that person's] line of duty." Barr v.

Matteo, 360 U.S. 564, 570-75 (1959); Westfall v. Erwin, 484 U.S. 292, 295-98 (1988). In Barr, supra, this Court went on to specifically reject the notion that a qualified privilege, which could be overcome by a showing of malice, would afford adequate protection to such statements. It is precisely that notion, a notion previously rejected by this Court, which served as the foundation for the decisions by both the Southern District and Second Circuit in the case at bar.

It is undisputed that this doctrine has been applied to communications made by private parties that are required to be made under federal law and that are essential to the proper functioning of government. In Becker v. Philco Corp., 372-F.2d 771 (4th Cir. 1967), defendant Philco, a defense contractor, had reported to the government that two of

its employees had compromised classified information. Under the applicable rules for dealing with classified information, Philco was required to make such a report. 372 F.2d at 772-73. Based upon that legal compulsion, the Fourth Circuit held that Philco's report to the government was absolutely privileged.

Likewise, in Bushman v. Seiler, 755 F.2d 653 (8th Cir. 1985), the official immunity doctrine was extended to a consultant to a Medicare carrier who wrote a letter suggesting that certain doctors had participated in a fraud on the Medicare system. While noting that the consultant's connection to the federal government was indirect, the Court observed that since Medicare carriers were required by regulation to carry out administrative responsibilities for the Department of Health and Human Services, similar

status should be extended to the consultant. 755 F.2d at 655. See, also, Gulati v. Zuckerman, 723 F.Supp. 353 (E.D.Pa. 1989).

A brokerage firm has the same sort of disclosure responsibilities. In conjunction with the SEC, the NASD and the SRO's, a brokerage firm's filings are an integral part of the self-regulatory structure that governs the securities industry. The Form U-5's play a critical role in that scheme. Whenever a registered representative has been terminated under circumstances which might call into question his honesty, integrity or willingness to follow the applicable laws and rules, those circumstances must be disclosed on Form U-5. Those rules and the prescribed form itself even require such disclosure where the questionable conduct is merely under investigation by

the firm. This requirement is obviously intended to provide the SEC, NASD or SRO's with the opportunity to investigate the matter themselves and to thereafter take any and all action they deem appropriate to protect the interests of the investing public. This may include disciplinary or remedial actions against the individual, the firm, or both.

As stated by this Court, the Second Circuit should have applied a balancing test; the Court should have determined whether in providing absolute protection to the statement at issue "the contribution to effective government... outweighs the potential harm to individual citizens." Westfall v. Erwin, 484 U.S. at 299. Under that test, the checking of a "YES" box on Form U-5 must qualify for an absolute privilege.

By the unqualified application of an absolute privilege to pertinent statements made on Form U-5 or any other similar mandated filing, this Court will ensure that securities firms will file complete and accurate Form U-5's. Such assurance is essential if such forms are to be useful to the enforcement and investigative functions of the SEC, NASD and the SRO's. Form U-5, like many other prescribed forms, requires a direct "YES" or "NO" answer to many of its inquiries. The response at issue was a "YES" response to a question which directed itself to whether the terminated representative was even under internal review for any possible wrongdoing. A "YES" response to that and any similar question simply cannot be allowed to receive only qualified protection. Absent an unqualified privilege, all reporting entities

subject to disclosure requirements will face a Hobson's choice: either answer honestly and thereby be exposed to liability for defamation, or provide responses that are less than candid and thereby render such filings meaningless. The Court below failed to recognize the importance of the Form U-5 as a protective device for the securities industry and the investing public. The Second Circuit was clearly erroneous in failing to find that statements made under such legal compulsion are absolutely privileged.

CONCLUSION

It is vital to the integrity of the securities industry that brokerage firms be totally candid when filing mandated forms. In order to do so, the firms must be protected from claims of defamation for pertinent statements made in these filings. Accordingly, the

Second Circuit decision extending only a qualified privilege to such statements was clearly erroneous.

We respectfully urge this Court to grant certiorari and reverse the decision below.

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 927, 928—August Term, 1990

(Argued: January 24, 1991 Decided: June 10, 1991)

Docket Nos. 90-7867, -7869

In the Matter of the New York Stock Exchange Arbitration between,
FAHNESTOCK & CO., INC.,

Petitioner-Appellant, Cross-Appellee,

—against—

JOSEPH J. WALTMAN,

Respondent-Appellee, Cross-Appellant.

Before:

VAN GRAAFEILAND, MINER and MAHONEY,
Circuit Judges.

Appeal and cross-appeal from judgment entered in United States District Court for the Southern District of New York (Leisure, *J.*) confirming compensatory damages

portion, and vacating punitive damages portion, of arbitration award against stock brokerage firm for defamation of discharged employee.

Judgment affirmed in all respects.

Judge Mahoney concurs in part and dissents in part in a separate opinion.

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Paul Windels III, New York, NY (Perry & Windels, New York, NY, William J. Fitzpatrick, Gerard J. Quinn, New York, NY, of counsel), *submitted a brief for amicus curiae the Securities Industry Association, Inc.*

MINER, *Circuit Judge*:

Petitioner-appellant, Fahnestock & Co., Inc. ("Fahnestock") appeals from a judgment entered in the United States District Court for the Southern District of New York (Leisure, *J.*) confirming the compensatory damages portion of an arbitration award in favor of its former

employee, Joseph J. Waltman. Waltman cross-appeals from the same judgment insofar as it vacates the punitive damages portion of the arbitration award.

On appeal, Fahnestock contends that the district court erred by denying its petition to vacate the entire defamation award because the members of the arbitration panel ("Arbitrators") exceeded their authority and manifestly disregarded the applicable law. Fahnestock argues that its filing of an amended Form U-5, a termination notice form that the National Association of Securities Dealers ("NASD") requires stock brokerage firms to file when they dismiss an employee, was absolutely privileged and could not serve as a basis for an award for defamation. On cross-appeal, Waltman argues that the court erred in vacating the Arbitrators' award for punitive damages because federal substantive law, as opposed to the New York law applied by the district court, permits such an award in arbitration proceedings brought pursuant to the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-14 (1988). For the reasons that follow, we affirm the judgment of the district court.

BACKGROUND

The arbitration proceeding subject of this action arose as a result of the events surrounding the discharge of Waltman from the employ of Fahnestock. Waltman was hired on March 16, 1982 as a "registered representative to head Fahnestock's Retirement Trust Division" and "to manage and build Fahnestock's insurance products business." During the course of his employment, in addition to overseeing Fahnestock's Retirement Division, Waltman acted as an insurance sub-licensee for Fahnestock. In

addition, he established a general insurance agency in Pennsylvania for the purpose of marketing insurance and annuity products for Fahnestock in Pennsylvania and other states. Waltman was discharged on December 12, 1988 when Fahnestock closed down its Retirement Trust Division.

When Waltman was terminated, Fahnestock filed a Form U-5 termination notice with the NASD, indicating that the discharge was occasioned by "business consolidation." When Fahnestock later was unable to locate some insurance files that it believed were maintained by Waltman, it contacted Waltman and requested that he return the files. Waltman refused to return the files, claiming that they belonged to his general insurance agency. Waltman explained that he would turn over the files only if Fahnestock obtained a release and indemnification from each registered agent named in the files.

Instead of complying with Waltman's request, Fahnestock filed a Statement of Claim with the Director of Arbitration of the New York Stock Exchange ("NYSE"), requesting the following relief: return of the original files, damages and costs, and other expenses. Fahnestock then filed an amended Form U-5. On the amended form, Fahnestock changed its previous answer in response to the question about whether the employee was under "internal review for fraud or wrongful taking of property, or violating investment-related statutes, regulations, rules or industry standards of conduct," from a "NO" to a "YES."

Waltman filed an answer in the NYSE arbitration, denying the allegations that he wrongfully took Fahnestock's property. He also filed a counterclaim, in which he alleged that Fahnestock and three of its officers, the chair-

man of the board, the president, and the general counsel, defamed him by filing the amended Form U-5.

During the course of eight hearings, the Arbitrators heard testimony concerning the chairman's threats to arrest Waltman for his failure to return the files, the chairman's instruction to refile the Form U-5 "in such a way as to indicate that [Waltman] had been fired for cause and noting that he had stolen property from Fahnestock," and the threats made to Waltman's current employer in an attempt to pressure Waltman into abandoning his defamation action. The Arbitrators awarded Waltman $56,000 in compensatory damages for wrongful discharge, $14,700 in legal fees, $100,000 for defamation and $100,000 in punitive damages. Liability was imposed on Fahnestock alone, and the claims against the individual officers were dismissed.

Waltman filed a petition to confirm the arbitral award under NYSE Arbitration rule 628(a) in the Eastern District of Pennsylvania. On March 15, 1990, Fahnestock filed a petition in the Southern District of New York to vacate the arbitral award under the Federal Arbitration Act, 9 U.S.C. § 10(d), claiming that the Arbitrators exceeded their authority by granting an award for defamation and by awarding punitive damages. No other challenges to the award were made. Federal jurisdiction was based on the diversity of the parties, as Fahnestock's principal place of business was New York and Waltman resided in Pennsylvania. The Eastern District of Pennsylvania court stayed the petition to confirm the arbitral award pending the outcome of the New York action to vacate it.

On August 22, 1990, the district court denied Fahnestock's petition to vacate the compensatory damages por-

tion of the arbitral award for defamation, but granted its petition to vacate the punitive damages portion of the award. The court rejected Fahnestock's claim that statements made in the amended Form U-5 were absolutely privileged. Instead, it found only a qualified privilege, which could be overcome upon a showing of malice or lack of probable cause for the statement. Holding that a finding of malice or probable cause was a factual matter and, as such, could be reviewed by the courts only on a limited basis, the court found that the Arbitrators did not exceed their powers in rendering the compensatory defamation award.

With respect to the punitive damages portion of the arbitral award, the district court, relying on *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976), held that the Arbitrators were prohibited from awarding punitive damages. In response to Fahnestock's contention that federal substantive law governs arbitrations conducted pursuant to the Federal Arbitration Act, the court held that "the state substantive law as set forth in *Garrity v. Lyle Stuart, Inc.* regarding the inability of arbitrators to award punitive damages, is not in direct conflict with any express provision of the Federal Arbitration Act," and therefore the application of *Garrity* would not violate the supremacy clause of the United States Constitution.

DISCUSSION

I. *Compensatory Award*

An arbitration award may be vacated "[w]here the arbitrators exceeded their powers," 9 U.S.C. § 10(d), or where the arbitrators acted in "manifest disregard of the law."

Carte Blanche (Singapore) Pte., Ltd. v. Carte Blanche Int'l, Ltd., 888 F.2d 260, 265 (2d Cir. 1989); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933-34 (2d Cir. 1986); *Siegel v. Titan Indus. Corp.*, 779 F.2d 891, 892 (2d Cir. 1985) (per curiam). Fahnestock asserts that the Arbitrators exceeded their powers and manifestly disregarded the law in granting an award for defamation based on its filing of the amended Form U-5. Fahnestock argues that, because it was required by law to file the form, the filing was subject to an absolute privilege. Therefore, it urges that the filing of the Form U-5 could not serve as a basis for an award for defamation. Fahnestock's arguments are without merit.

We have consistently accorded the narrowest reading to section 10(d), "especially when it 'has been invoked in the context of the arbitrators' alleged failure to correctly decide a question which all concede to have been properly submitted in the first instance.' " *Synergy Gas Co. v. Sasso*, 853 F.2d 59, 63 (2d Cir.) (citation omitted), *cert. denied*, 488 U.S. 994 (1988). Consequently, we have recognized that if arbitrators "rule[ ] on issues not presented to [them] by the parties, [they have] exceeded [their] authority and the award must be vacated." *Dighello v. Busconi*, 673 F. Supp. 85, 87 (D. Conn. 1987), *aff'd mem.*, 849 F.2d 1467 (2d Cir. 1988); *see Andros Compania Maritima, S.A. v. Marc Rich & Co., A.G.*, 579 F.2d 691, 703 (2d Cir. 1978). Here, it is uncontested that the ruling of the Arbitrators was confined to the issues presented by the parties. Moreover, we have recognized that defamation claims based on statements in a Form U-5 are arbitrable. *See Fleck v. E.F. Hutton Group, Inc.*, 891 F.2d 1047, 1049, 1053 (2d Cir. 1989). Therefore, any argument that it is beyond the power of arbitrators to decide these types of claims is contrary to the law of this circuit.

Nor are we persuaded that the Arbitrators manifestly disregarded the law in awarding Waltman damages for defamation. Judicial inquiry under the manifest disregard standard likewise is extremely limited. *Bobker*, 808 F.2d at 933-34. We have held that there must be " 'something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand or apply the law,' " *Siegel*, 779 F.2d at 892 (citation omitted), in order to sustain a finding of manifest disregard of the law. Illustrative of the degree of "disregard" necessary to support vacatur under this standard is our holding that manifest disregard will be found where an "arbitrator 'understood and correctly stated the law but proceeded to ignore it.' " *Id.* at 893 (citation omitted).

Under New York law, "[a] communication is said to be qualifiedly privileged where it 'is fairly made by a person in the discharge of some public or private duty, legal or moral, or in the conduct of his own affairs, in a matter where his interest is concerned." *Toker v. Pollak*, 44 N.Y.2d 211, 219, 376 N.E.2d 163, 166, 405 N.Y.S.2d 1, 5 (1978); *see also Mihlovan v. Grozavu*, 72 N.Y.2d 506, 509, 531 N.E.2d 288, 289, 534 N.Y.S.2d 656, 657 (1988) (per curiam); *Shapiro v. Health Ins. Plan of Greater New York*, 7 N.Y.2d 56, 60, 163 N.E.2d 333, 336, 194 N.Y.S.2d 509, 512-13 (1959). The qualified privilege, however, can be vitiated upon a showing that the communication was made with actual malice. *Park Knoll Assocs. v. Schmidt*, 59 N.Y.2d 205, 211, 451 N.E.2d 182, 185, 464 N.Y.S.2d 424, 427 (1983); *see also Mihlovan*, 72 N.Y.2d at 509, 531 N.E.2d at 289, 534 N.Y.S.2d at 657-58. Actual malice has been defined as " 'personal spite or ill will, or culpable recklessness or negligence.' " *Garson v. Hendlin*, 141 A.D.2d 55, 64, 532 N.Y.S.2d 776, 782 (2d Dep't 1988) (citation omitted).

At the arbitration hearings, the Arbitrators heard testimony that the chairman of Fahnestock gave instructions to refile the Form U-5 "in such a way as to indicate that [Waltman] had been fired for cause and . . . that he had stolen property from Fahnestock." Fahnestock's former managing director testified that the amended Form U-5 was filed at the command of Fahnestock's chairman for the specific purpose of damaging Waltman's reputation rather than for a regulatory purpose. Additionally, evidence was introduced that Fahnestock attempted to force Waltman to drop his counterclaim by threatening his current employer.

Here, the Arbitrators never indicated the reasons for the defamation award. However, it is axiomatic that arbitrators need not disclose the rationale for their award. *United Steelworkers of Am. v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 598 (1960); *Koch Oil, S.A. v. Transocean Gulf Oil Co.*, 751 F.2d 551, 554 (2d Cir. 1985). "[I]f a ground for the arbitrator's decision can be inferred from the facts of the case, the award should be confirmed." *Sobel v. Hertz, Warner & Co.*, 469 F.2d 1211, 1216 (2d Cir. 1972); *see Siegel*, 779 F.2d at 894. Therefore, even though Fahnestock was protected by the qualified privilege in filing the amended form, based on the evidence, the arbitrators acted well within the bounds of their broad authority in making an award of compensatory damages in favor of Waltman. *See In re Marine Pollution Serv., Inc.*, 857 F.2d 91, 94 (2d Cir. 1988) (any "colorable justification" will support an arbitral award); *Andros Compania*, 579 F.2d at 704. The ample evidence of Fahnestock's flagrantly spiteful conduct, demonstrating its intent simply to injure Waltman's reputation, presented the Arbitrators with sufficient grounds to find that no qualified privilege attached to Fahnestock's filing of the

amended form. *See Garson*, 141 A.D.2d at 65, 532 N.Y.S.2d at 782. It is apparent that the Arbitrators declined to extend the doctrine of absolute immunity to statements made to the NASD, a quasi-official body. *Cf. Toker*, 44 N.Y.2d at 222-23, 376 N.E.2d at 168-69, 405 N.Y.S.2d at 7; *Garson*, 141 A.D.2d at 59-60, 532 N.Y.S.2d at 779. Therefore, under these circumstances, we agree with the district court that the Arbitrators' compensatory defamation award in favor of Waltman should be confirmed.

II. *Punitive Damages Award*

On cross-appeal, Waltman argues that the district court erred in vacating the punitive damages portion of the Arbitrators' award. The district court perceived that the governing rule was established by the New York Court of Appeals: "An arbitrator has no power to award punitive damages, even if agreed upon by the parties." *Garrity*, 40 N.Y.2d at 356, 353 N.E.2d at 795, 386 N.Y.S.2d at 832. The *Garrity* rule is bottomed on policy considerations deemed controlling by New York's highest court: "[E]nforcement of an [arbitrator's] award of punitive damages as a purely private remedy would violate strong public policy." *Id.* The rule maintains its vitality in the courts of New York. *See, e.g., Diker v. Cathray Constr. Corp.*, 158 A.D.2d 657, 658, 552 N.Y.S.2d 37, 38 (2d Dep't 1990); *Belco Petroleum Corp. v. AIG Oil Rig, Inc.*, 164 A.D.2d 583, ___, 565 N.Y.S.2d 776, 784 (1st Dep't 1991).

Waltman's challenge to the district court judgment is premised on the federal substantive law of arbitrability: "Section 2 [of the FAA, 9 U.S.C. § 2,] is a congressional declaration of a liberal federal policy favoring arbitration agreements . . . . The effect of the section is to create a

body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). Since the agreement between the parties falls within the coverage of the FAA, allows for the arbitration of any dispute between them and includes no restriction on the award of punitive damages under the governing rules of the New York Stock Exchange, Waltman urges that there should be no bar to the award of punitive damages under federal substantive arbitration law. Indeed, there is precedent for Waltman's position that federal law and policy confers upon FAA arbitrators the right to award punitive damages even where, as is not the case here, the arbitration parties agree that New York law is to govern. *See, e.g., Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1386-88 (11th Cir. 1988); *Barbier v. Shearson Lehman Hutton, Inc.*, 752 F. Supp. 151 (S.D.N.Y. 1990); *Singer v. E.F. Hutton & Co.*, 699 F. Supp. 276 (S.D. Fla. 1988); *Duggal Int'l Inc. v. Sallmetal, B.V.*, No. 84 Civ. 7170 (JMC) (S.D.N.Y. May 8, 1986). Our view is somewhat different.

While it is true that in enacting the FAA, "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements," *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984), it also is true that "[t]he FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration," *Volt Info. Sciences v. Board of Trustees of the Leland Stanford Jr. Univ.*, 489 U.S. 468, 477 (1989). Accordingly, state law may be applied in arbitration matters, subject to preemption only "to the extent that it actually conflicts with federal law." *Id.*; *see also Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (preemption is found in cases where state law "stands as an obstacle to

the accomplishment and execution of the full purposes and objectives of Congress."). We find no conflict between the provisions of the FAA and the *Garrity* rule.

What the FAA requires is that parties comply with their agreements to arbitrate. " '[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.' " *AT&T Technologies, Inc. v. Communications Workers of Am.*, 475 U.S. 643, 648 (1986) (citation omitted); *see also New York News Inc. v. Newspaper Guild of New York*, 927 F.2d 82, 84 (2d Cir. 1991); *Neechi v. Neechi Sewing Mach. Sales Corp.*, 348 F.2d 693, 696 (2d Cir. 1965), *cert. denied*, 383 U.S. 909 (1966). Waltman's defamation claim certainly was a matter for arbitration pursuant to the agreement of the parties, but there was no agreement as to whether punitive damages were allowable. If the parties had agreed to permit the arbitrators to make such an award, federal arbitration law might require confirmation, for "parties are generally free to structure their arbitration agreements as they see fit," and the FAA provides for enforcement of the terms of such privately negotiated agreements. *Volt Information Sciences*, 489 U.S. at 478-79. The body of preemptive federal substantive law that supports the FAA has developed largely in response to state laws that restrict arbitration in derogation of agreements freely negotiated. *See, e.g., Perry v. Thomas*, 482 U.S. 483, 489-90 (1987). The FAA itself was designed "to make arbitration agreements as enforceable as other contracts," *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) and "to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985). The federal substantive law of arbitration assures the accomplishment of these purposes.

Why should state law be applied in this case, where the parties have not specified remedies and where the arbitrators therefore should be free to fashion appropriate relief? The answer lies in the jurisdictional basis of the action giving rise to this appeal. While the FAA "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, . . . it does not create any independent federal question jurisdiction . . . ." *Moses H. Cone*, 460 U.S. at 25 n.32. Some independent basis for federal jurisdiction must be established. The petition in the case at bar has invoked the diversity of citizenship of the parties as a means of acquiring subject matter jurisdiction. 28 U.S.C. § 1332. The award of the arbitrators was before the district court in this diversity case for review under state law. As previously noted, state law relating to the propriety of a punitive damages award by arbitrators in the absence of an agreement on the subject is not preempted by any federal substantive law bearing on the subject.

Ordinarily, "[i]n a diversity action, or in any other lawsuit where state law provides the basis of decision, the propriety of an award of punitive damages for the conduct in question . . . [is a] question[ ] of state law." *Browning-Ferris Indus. v. Kelco Disposal, Inc.*, 492 U.S. 257, 278 (1989). The measure of damages in general is a matter controlled by New York substantive law where federal jurisdiction in New York is predicated on the diversity of the parties. *See Shu-Tao Lin v. McDonnell Douglas Corp.*, 742 F.2d 45, 49 n.5. (2d Cir. 1984); *Van Gemert v. Boeing Co.*, 553 F.2d 812, 813 (2d Cir. 1977). It follows that in this action the *Garrity* rule prohibiting the award of punitive damages by arbitration must be applied. That the rule is grounded in state policy concerns renders it no less a rule of substantive law. *See* Stewart, *Punitive Damages*

Arbitration: Fish or Cut Bait, N.Y.L.J., Feb. 21, 1991, at 5, col. 1.

We emphasize that an agreement between the parties specifically to award punitive damages may well have dictated a different outcome. The *Garrity* rule, to the extent that it purports to prevent arbitrators from awarding punitive damages in the face of such an agreement, seems to invoke preemption concerns, since it runs afoul of the federal substantive law rules that sweep aside any state attempt to interfere with the agreement of the parties. The matter may be left for another day, however, because we deal here only with the NYSE provisions for arbitration.

Article XI of the NYSE Constitution provides that "[a]ny controversy between . . . a member, allied member or member organization and any other person, arising out of the business of such member . . . , shall at the instance of any such party, be submitted for arbitration . . . ." 2 N.Y.S.E. Guide (CCH) ¶ 1501. Additionally, NYSE rule 600(a) provides for the arbitration of "[a]ny dispute, claim or controversy," 2 N.Y.S.E. Guide (CCH) ¶ 2600, and NYSE rule 347 provides for the arbitration of "any controversy . . . arising out of the employment or termination of employment . . . ," 2 N.Y.S.E. Guide (CCH) ¶ 2347.

Despite this broad language, the NYSE provisions are silent with regard to the power of arbitrators to award punitive damages. As the district court observed, unlike the cases involving arbitration agreements incorporating the rules of the American Arbitration Association ("AAA"), which provide that arbitrators may award "any remedy or relief which [is] just and equitable and within the scope of the agreement," *see Bonar*, 835 F.2d at 1386 (upholding AAA award of punitive damages); *Raytheon*

Co. v. Automated Business Sys., Inc., 882 F.2d 6, 9 (1st Cir. 1989) (same), the NYSE rules have no provisions relating to remedy or relief. Clearly, if the NYSE wanted to empower arbitrators to award punitive damages, it could have done so. *See* Friedman, *Punitive Damages in Securities Cases*, N.Y.L.J., May 2, 1991, at 3, col. 1.

Waltman points to the award form, which is used by NYSE arbitrators to memorialize the arbitral awards and allows for entry of a punitive damages award under a specific heading marked "punitive damages," to support his contention that NYSE arbitrators are empowered to award punitive damages. We cannot conclude that award forms are part of the arbitration agreement. Moreover, NYSE arbitrations occur throughout the nation, and our holding here does not mean that in those states in which arbitral punitive damages awards are permitted, arbitrators may not appropriately utilize the punitive damages section of the award form.

In a recent decision of this Court, the panel in dictum noted that "in an appropriate case, the arbitrators could enhance [an award] by punitive damages if prior misconduct established entitlement to such damages." *Kerr-McGee Refining Corp. v. M/T Triumph*, 924 F.2d 467, 470 (2d Cir. 1991) (citing *Bonar*, 835 F.2d at 1387). In *Kerr-McGee*, the plaintiff was awarded treble damages under the Racketeer Influenced and Corrupt Organizations ("RICO") Act, 18 U.S.C. §§ 1961-1968, in an arbitration proceeding. 924 F.2d at 469-70. *Kerr-McGee*, however, was not a diversity case requiring a preemption analysis, since RICO there provided federal question jurisdiction under 28 U.S.C. § 1331.

Although "[w]e have consistently accorded the narrowest of readings to the Arbitration Act's authorization

to vacate awards," *Andros Compania*, 579 F.2d at 703, we also have noted that under *Garrity* an arbitral award of punitive damages must be vacated in an appropriate case. *See John T. Brady & Co. v. Form-Eze Sys., Inc.*, 623 F.2d 261, 263 (2d Cir.) (" 'where the damages are genuinely intended to be punitive[,] . . . the courts [should] vacate the award' " (citation omitted)), *cert. denied*, 449 U.S. 1062 (1980); *see also Synergy Gas Co. v. Sasso*, 853 F.2d 59, 65-66 (2d Cir.) (dicta), *cert. denied*, 488 U.S. 994 (1988). For the reasons given, this is an appropriate case under the provisions of section 10(d) of the FAA for vacatur of the punitive damages award.

CONCLUSION

The judgment of the district court is affirmed in all respects.

MAHONEY, *Circuit Judge*, concurring in part and dissenting in part:

I join the majority opinion insofar as it affirms that portion of the judgment below which confirmed the arbitral award of compensatory damages. I respectfully dissent, however, from the majority's affirmance of the district court's vacatur of the arbitral award of punitive damages.

The majority recognizes the fundamental requirement of the FAA "that parties comply with their agreements to arbitrate." They further concede that "the parties have not specified remedies and . . . the arbitrators therefore should be free to fashion appropriate relief." They deem these considerations outweighed, however, by the fact that

diversity of citizenship provides the basis for federal jurisdiction in this case. This leads them to apply normally applicable diversity rules, and thus to conclude that the availability of punitive damages is a question of substantive law for which state law provides the rule of decision. Deeming New York law applicable, they then invoke *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976), to affirm the district court's vacatur of the arbitral award of punitive damages.

In my view, this analysis misreads the applicable law and creates an unnecessary conflict with two of our sister circuits. As the Supreme Court stated in *Moses M. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1982):

> The Arbitration Act is something of an anomaly in the field of federal-court jurisdiction. It creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent federal-question jurisdiction under 28 U.S.C. § 1331 (1976 ed., Supp. V) or otherwise. Section 4 provides for an order compelling arbitration only when the federal district court would have jurisdiction over a suit on the underlying dispute; hence, there must be diversity of citizenship or some other independent basis for federal jurisdiction before the order can issue.

Id. at 25 n.32 (emphasis added).

The majority's approach effectively disregards the existence of a "body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate," *id.*, and imposes the diversity regime of *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938). The *Erie* standard is intended, however, for "all matters except those in which

some federal law is controlling." *Id.* at 72. It therefore seems to me clearly inappropriate to apply *Erie*-generated rules to an area for which, the Supreme Court has instructed, federal law supplies the rule of decision. That, however, is precisely what the majority has done in this case.

The Supreme Court has continually reiterated that the FAA "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Volt Information Sciences, Inc. v. Board of Trustees*, 489 U.S. 468, 478 (1989). As the Court stated in *Volt*:

> The FAA was designed "to overrule the judiciary's long-standing refusal to enforce agreements to arbitrate," Dean Witter Reynolds Inc. v. Byrd, 470 U.S. [213, 219-20 (1985)], and to place such agreements " 'upon the same footing as other contracts,' " Scherk v. Alberto-Culver Co., 417 U.S. [506, 511 (1974)] (quoting H.R Rep. No. 96, 68th Cong., 1st Sess., 1, 2 (1924)). While Congress was no doubt aware that the Act would encourage the expeditious resolution of disputes, its passage "was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered." Byrd, 470 U.S., at 220.

Id. Accordingly, the FAA mandates district courts, upon application, to "direct[ ] that . . . arbitration proceed *in the manner provided for in [the parties'] agreement.*" 9 U.S.C. § 4 (1988) (emphasis added).

It follows that a state law which limits freedom of contract with respect to arbitration agreements covered by the FAA conflicts with the FAA and is preempted by it. *See Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 722

(4th Cir.) ("with few limitations, if a state law singles out arbitration agreements and limits their enforceability it is preempted."), *cert. denied*, 111 S. Ct. 516 (1990); *cf. Volt*, 489 U.S. at 479 ("Arbitration under the [FAA] is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit.").

As a result, the cases that have addressed the question whether punitive damages may be awarded in arbitration have looked to the agreement between the parties to resolve the issue. *See, e.g., Raytheon Co. v. Automated Business Sys.*, 882 F.2d 6, 9-12 (1st Cir. 1989); *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1386-88 (11th Cir. 1988); *Pyle v. Securities U.S.A., Inc.*, 758 F. Supp. 638, 639 (D. Colo. 1991); *Barbier v. Shearson Lehman Hutton, Inc.*, 752 F. Supp. 151, 159-60 (S.D.N.Y. 1990); *Peabody v. Rotan Mosle, Inc.*, 677 F. Supp. 1135, 1139 (M.D. Fla. 1987); *Ehrich v. A.G. Edwards & Sons, Inc.*, 675 F. Supp., 559, 563 (D.S.D. 1987); *Duggal Int'l, Inc. v. Sallmetall, B.V.*, No. 84 Civ 7170 (JMC) (S.D.N.Y. May 8, 1986); *Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc.*, 598 F. Supp. 353, 357-59 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985) (per curiam); *Willis v. Shearson/American Express, Inc.*, 569 F. Supp. 821, 823 (M.D.N.C. 1983).

Further, as the majority recognizes, courts have rebuffed efforts to invoke *Garrity* to preclude an arbitral award of punitive damages even where the pertinent contract explicitly stated that it was to be governed by New York law. *See, e.g., Bonar*, 835 F.2d at 1386-87; *Barbier*, 752 F. Supp. at 153, 160 & n.15; *Singer v. E.F. Hutton & Co.*, 699 F. Supp. 276, 278-79 (S.D. Fla. 1988); *Duggal Int'l*, slip op. at ___, ___ n.4; *Willis*, 569 F. Supp. at 823-24; *see also Raytheon*, 882 F.2d at 11 (rejecting *Garrity*),

Ehrich, 675 F. Supp. at 565 (same); *Willoughby*, 598 F. Supp. at 359 (same).

If an express provision that a contract will be governed by New York law does not suffice to render an arbitration under that contract subject to *Garrity*, it must surely follow *a fortiori* that the mere invocation of diversity jurisdiction does not do so. Further, the imposition of the *Garrity* rule, without respect to (or any meaningful inquiry regarding) the contractual intention of the parties, directly contravenes the dominant purpose and policy of the FAA as repeatedly articulated by the Supreme Court.

The district court herein ruled that because Garrity "is not in direct conflict with any express provision of the [FAA]," it should be invoked to preclude any award of punitive damages. *Fahnestock & Co. v. Waltman*, No. 90 Civ. 1792 (PKL), slip op. at 10 (S.D.N.Y. Aug. 23, 1990). Although the contract at issue was distinguished from contracts incorporating an American Arbitration Association rule that is often read to authorize an award of punitive damages, *id.* at 11, no significant inquiry was conducted regarding the intent of the parties, and no mention was made of the NYSE award form, applicable here, that makes specific provision for punitive damages. Rather, *Garrity* was deemed controlling as a matter of law.

In affirming, my colleagues dismiss the award form because they "cannot conclude that award forms are part of the arbitration agreement." Indeed, in the absence of any consideration of the issue by the district court, it is impossible on this record to reach any conclusion pro or con regarding the matter, or more generally regarding the intent of the parties as to the award of punitive damages. The majority makes clear, in any event, that it "might"

defer only to an explicit agreement between the parties authorizing an award of punitive damages.

Given the rule that "ambiguities as to the scope of the arbitration clause [are] resolved in favor of arbitration," *Volt*, 489 U.S. at 476; *see also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 626 (1985) ("as with any other contract, the parties' intentions control, but those intentions are generously construed as to arbitrability."); *Moses M. Cone*, 460 U.S. at 24-25 ("any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration"), a much more hospitable approach to arbitral power to award punitive damages is appropriate. In any event, *some* significant inquiry as to contractual intent is required. Clearly, none has occurred here.

I would therefore reverse the ruling of the district court vacating the arbitral award of punitive damages and remand for reconsideration of that issue in terms of the contractual intent of the parties. I am not prepared to conclude at this juncture that the outcome of that necessarily particularized inquiry will result in a different outcome on this issue. I am convinced, however, that the inquiry should be undertaken, rather than aborted by the invocation of *Garrity*.

No precedent of this court calls for a different result. *John T. Brady & Co. v. Form-Eze Systems, Inc.*, 623 F.2d 261, 263-64 (2d Cir.), *cert. denied*, 449 U.S. 1062 (1980), discussed *Garrity*, but concluded that no award of punitive damages had been made requiring any ruling on the issue in that case. *Synergy Gas Co. v. Sasso*, 853 F.2d 59, 65 (2d Cir.), *cert. denied*, 488 U.S. 994 (1988), similarly dismissed an argument premised upon *Garrity* because the arbitral award was construed not to include punitive

damages. Accordingly, neither case had any occasion to address the issue whether *Garrity* can operate to preclude punitive damages awards in FAA arbitrations. In any event, any ruling giving that effect to *Garrity* would be inconsistent with *Moses M. Cone's* teaching that the FAA "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." 460 U.S. at 25 n. 32. More recently, in *Kerr-McGee Refining Corp. v. M/T Triumph*, 924 F.2d 467, 470 (2d Cir. 1991), we stated, in the context of an arbitration of a RICO claim, that punitive damages could be awarded "in an appropriate case," citing *Bonar*.

Although our precedents are ambiguous, I conclude that governing Supreme Court doctrine, the vast weight of federal court authority on the issue, and basic principles of federal arbitration law counsel against the ruling of the majority in this case on the issue of punitive damages. I therefore respectfully dissent from that ruling.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter of The New York Stock Exchange Arbitration Between	:	90 Civ. 1792 (PKL)
FAHNESTOCK & CO., INC., Petitioner,	:	Opinion & Order
-against-	:	
JOSEPH J. WALTMAN, Respondent.	:	

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LEISURE, District Judge:

This action was brought by petitioner Fahnestock and Co., Inc. ("Fahnestock") to vacate an arbitration award rendered by the New York Stock Exchange, pursuant to the Federal Arbitration Act, 9 U.S.C. § 10. The arbitrators awarded damages to respondent Joseph J. Waltman ("Waltman") for defamation and wrongful termination of employment by Fahnestock. Fahnestock seeks to vacate this award on the grounds that the arbitrators exceeded their power by ignoring certain policies of the New York Stock Exchange, Inc. ("NYSE") and National Association of Securities Dealers, Inc. ("NASD"), and by rendering an award of punitive damages. Respondent seeks to dismiss this petition pursuant to Fed. R. Civ. P. 12(b)(3) and 12(b)(6), or in the alternative, to transfer the action to

the United States District Court for the Eastern District of Pennsylvania, pursuant to 28 U.S.C. § 1410(a).

BACKGROUND

Fahnestock is a securities corporation with its principal place of business in New York. On March 16, 1982, Fahnestock hired defendant Waltman as an at-will employee, to serve in the capacity of a "registered representative to head Fahnestock's Retirement Trust Division and thereafter, at Fahnestock's request, to manage and build Fahnestock's insurance products business." Petition to Vacate, ¶ 5. Waltman was based in New York and Pennsylvania. In addition to his work with Fahnestock, Waltman, in 1985, established a general insurance agency in Pennsylvania for the purpose of marketing insurance and annuity products in Pennsylvania and other states, in

connection with Keystone Providence Live Insurance Company.

On December 12, 1988, Fahnestock notified Waltman that his employment with the company had been terminated, and subsequently, filed a Uniform Termination Statement ("Form U-5") with the National Association of Securities Dealers to record Waltman's discharge. Petition to Vacate, Exhibit A. Fahnestock was later allegedly unable to locate certain insurance files, and believed that, since Waltman had been responsible for the files, he had retained them. Fahnestock, therefore, requested that the files be returned. Waltman, however, contended that the files in question were materials which were used in connection with his general insurance agency. Waltman then supplied Fahnestock with a list of account executives about which the files he

retained were concerned, and offered to make available the information contained in the files, in return for the release and indemnification of Waltman against any and all claims. Respondent's Memorandum of Law, Exhibit A.

Fahnestock, instead of complying with Waltman's request, filed a statement of claim with the Arbitration Department of the New York Stock Exchange on January 27, 1989, requesting investigation of the matter. Petition to Vacate, Exhibit B. Subsequently, Fahnestock filed an amended Form U-5 noting the commencement of the arbitration, and that Waltman was under "internal review for fraud or wrongful taking of property, or violating investment related statutes, regulations, rules or industry standards of conduct." Petition to Vacate, Exhibit C.

Waltman, on March 20, 1989, served an answer and counterclaim in the New York Stock Exchange arbitration, in which he denied Fahnestock's allegations and maintained that he had been wrongfully terminated. In addition, Waltman alleged that Fahnestock and three individually named defendants -- the Chairman of the Board, the President, and the General Counsel of Fahnestock -- had defamed him by filing the amended Form U-5 with the National Association of Securities Dealers. Waltman alleged that Fahnestock participated in needless and malicious harassment which "resulted in a permanent record of alleged misconduct through Fahnestock's filing of an amended U-5 with the NASD after it filed its claim against him." Respondent's Memorandum of Law, p.2.

On January 19, 1990 the arbitrators

rendered their decision, and awarded $56,000.00 to Waltman in compensatory damages, in addition to $14,000.00 for legal fees, $100,000.00 for defamation in filing the amended Form U-5, and $100,000.00 in punitive damages. Petition to Vacate, Exhibit E.

Waltman then filed a petition in the United States District Court for the Eastern District of Pennsylvania to confirm and enter judgment on the arbitration award, pursuant to New York Stock Exchange Arbitration Rule 628(a). On March 15, 1990 Fahnestock filed the instant petition to vacate the award of the arbitrators pursuant to 9 U.S.C. § 10, alleging that the arbitrators

"exceeded their powers"[1] by rendering a defamation award and by awarding punitive damages. Judge J. William Ditter, Jr., United States District Judge for the Eastern District of

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[1] The Federal Arbitration Act, 9 U.S.C. § 10, provides that an arbitration award may be vacated:

> (a) Where the award was procured by corruption, fraud, or undue means.
> (b) Where there was evident partiality or corruption in the arbitrators, or either of them.
> (c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
> (d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

Pennsylvania rendered a decision dated May 22, 1990, staying the petition to confirm the award of the arbitrators "pending the outcome of [Fahnestock's] petition to vacate, filed in the Southern District of New York." Petitioner's Reply Memorandum, Exhibit A. Respondent, in response, has filed a motion to dismiss for improper venue, or in the alternative, to transfer the instant action to the Eastern District of Pennsylvania.

DISCUSSION

A. Petitioner's Motion to Vacate the Arbitration Award

Petitioner seeks vacatur of the arbitration award maintaining that the arbitration committee exceeded its power by disregarding the law with respect to certain New York Stock Exchange and National Association of Securities Dealers regulations, and with respect to

the privilege afforded any discharge of a public or private duty, attached thereto. Fahnestock also maintains that the arbitrators disregarded the legal privilege imparted to all statements made in the course of a judicial or quasi-judicial proceeding, which would protect the statement of claim against Waltman as filed by Fahnestock. In addition, Fahnestock argues, the arbitration panel exceeded its power by granting an award of punitive damages.

It is a well established principal that "arbitrators may render a lump sum award without disclosing their rationale for it, and that when they do, courts will not inquire into the basis of the award unless they believe that the arbitrators rendered it in 'manifest disregard' of the law . . . " Koch Oil S.A. v. Transocean Gulf Oil Co., 751 F.2d 551 (2d Cir. 1985) (citing Kurt

Orban Co. v. Angeles Metal Systems, 573 F.2d 739, 740 (2d Cir. 1978)). The "manifest disregard" doctrine was judicially created by the Supreme Court in Wilko v. Swan, 346 U.S. 427 (1953), as an extension of 9 U.S.C. § 10(d) which provides for vacatur of an arbitration award upon a showing that the arbitrators "exceeded their powers." The doctrine is "extremely limited", and hence, the Court is "not at liberty to set aside an arbitration panel's award because of an arguable difference regarding the meaning or applicability of laws urged upon it." Merrill Lynch, Pierce, Fenner, and Smith, Inc. v. Bobker, 808 F.2d 930, 934 (2d Cir. 1986). See also Reynolds Secur., Inc. v. Macquown, 459 F.Supp. 943, 945 (W.D.Pa. 1978). This standard "presupposes something beyond and different from a mere error in the law

or failure on the part of arbitrators to understand or apply the law." Saxis Steamship Co. v. Multifacs International Traders, Inc., 375 F.2d 577, 582 (2d Cir. 1967) (citing San Martine Companie de Maregacion v. Saqueray Terminal Ltd., 293 F.2d 796, 801 (9th Cir. 1961)). See also Synergy Gas Co. v. Sasso, 853 F.2d 59 (2d Cir.), cert. denied, 109 S. Ct. 559 (1988). Thus, the complaining party must prove that the arbitrators "understood and correctly stated," yet completely ignored the law, in order to establish that an arbitration award should be vacated on the grounds of "manifest disregard." Id.

In the instant case, petitioner maintains that the arbitration committee disregarded the NASD and NYSE regulations which require that an amended Form U-5 be filed in the event that any inaccuracies develop in the

original Form U-5. Fahnestock argues that it was obligated to disclose the commencement of Waltman's investigation regarding "possible fraud or wrongful taking" of the insurance files in question, and that since the arbitrators were aware of this obligation and nonetheless granted the defamation award, manifest disregard is obvious.

The Court has conducted a thorough and complete review of the entire record, and is unable to conclude that the arbitrators exceeded their power by ignoring the NASD and NYSE regulations. The arbitrators considered the regulations, as evidenced in the transcript of the arbitration proceedings, and rendered a decision based on their interpretation of the regulations. Furthermore, according to the "manifest disregard" standard for vacatur, the Court is not empowered to

set aside the decision of the arbitration committee because of disagreement about the interpretation of the regulations at issue. Nor may the Court inquire into the rationale of the arbitrators in rendering the award.

Petitioner also argues that the filing of the amended Form U-5 was protected by an absolute privilege which is afforded to any discharge of a public or private duty. The Court has reviewed the relevant caselaw presented by petitioner, and concludes that a detailed examination of the law reveals that such privilege is not absolute, and may be overcome by a showing of malice. For example, in Greenfield v. Kanwit, 546 F.Supp. 220 (S.D.N.Y.), aff'd without op., 714 F.2d 113 (2d Cir. 1982), the Court recognized that "New York extends a common law privilege to any communication made in discharge of a

private or public duty, whether legal or moral." 546 F.Supp. at 227 (citing Shapiro v. Health Ins. Plan of Greater New York, 7 N.Y.2d 56, 194 N.Y.S.2d 509, 163 N.E.2d 333 (1959)). The court, however, concluded that such privilege is not absolute and "may be overcome by a showing that the statement was motivated or actuated by actual malice." Id. (citing Perfect Fit Industries v. Acme Quilting Co., 494 F.Supp. 505 (S.D.N.Y. 1980)). Therefore, in the instant case, although the filing of the amended Form U-5 can be interpreted as the discharge of a private duty and is thus privileged, the arbitrators may have concluded that the privilege was overcome by the existence of actual malice. A finding of malice is an issue of fact and, therefore, unreviewable on a motion to vacate.

Petitioner also maintains that the

arbitrators ignored the governing legal principal with respect to the absolute privilege which is imparted to any communication made in light of a judicial or quasi-judicial proceeding. Fahnestock contends that the filing of the statement of claim enjoyed such privilege as a pleading in a quasi-judicial proceeding. A closer examination of the relevant caselaw presented by petitioner in support of this proposition also reveals that such privilege is not absolute and may be overcome by a showing of malice or lack of probable cause. The privilege was discussed in Lewis v. Elliott, 628 F.Supp. 512 (D.D.C. 1986), a defamation action based on an "allegedly defamatory publication contained in affidavit attached to a bid protest letter," brought by a federal employee against two corporations. Id. Although the

court recognized that statements made prior to or in the course of a judicial or quasi-judicial proceeding are absolutely privileged, and that such proceedings include arbitration proceedings, Id. at 516 (citing Sturdivanet v. Seaboard Service System, Ltd., 459 A.2d 1058, 1060 (D.C. App. 1983)), the court concluded that such statements are privileged "only if it appears that the affiant had probable cause to make the affidavit. Id., at 517, (citing King v. Hildebrandt, 331 F.2d 476 (2d Cir. 1964). See also Youmans v. Smith, 153 N.Y. 214, 47 N.E. 265 (1897). Similarly, in Meyers v. Amerada Hess Corp., 647 F.Supp. 62 (S.D.N.Y. 1986), the court recognized that the privilege can be waived if abused. The court reasoned that the "accepted standard for determining whether there has been an abuse of the

privilege requires the court to determine whether the statements are 'so obviously impertinent as not to admit of discussion, and so needlessly defamatory as to warrant the inference of express malice'." Id., at 65-66 (quoting Youmans v. Smith, 153 N.Y. 214, 220, 47 N.E. 265 (1897)).

The Court concludes that a showing of actual malice or lack of probable cause can overcome the privilege afforded to communications made in a quasi-judicial proceeding. As previously discussed, the existence of actual malice is a question of fact and the Court may not inquire into the rationale of the arbitration committee in rendering the award. Thus, the arbitration committee may indeed have determined that a waiver of the privilege was appropriate in the instant case.

Fahnestock also argues that the arbitration panel exceeded its power in rendering an award of punitive damages to Waltman and that therefore, this portion of the award should be vacated. Fahnestock argues that, under New York law, an arbitration panel is not empowered to grant punitive damages. Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976). In Garrity, the New York Court of Appeals held that "an arbitrator has no power to award punitive damages, even if agreed upon by the parties." Id. at 832. The court reasoned that "enforcement of an award of punitive damages as a purely private remedy would violate public policy . . .", and thus, any such award imposed by an arbitrator should be vacated. Id. at 356-57.

Respondent maintains that federal substantive law governs any arbitration

conducted pursuant to the Federal Arbitration Act, and therefore, an award of punitive damages is appropriate. In support of this proposition, respondent relies on the United States Supreme Court decision in Southland Corp. v. Keating, 465 U.S. 1 (1984). In Southland, the Court determined that any state law which is in direct conflict with the Federal Arbitration Act is violative of the Supremacy Clause of the United States Constitution. The Court explained that "[t]he Arbitration Act 'creates a body of federal substantive law' . . . applicable in state and federal courts." Id. at 12 (quoting Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 25 n.32 (1983). In the instant case, however, the state substantive law as set forth in Garrity v. Lyle Stuart, Inc. regarding the inability of

arbitrators to award punitive damages, is not in direct conflict with any express provision of the Federal Arbitration Act. Therefore, the Supreme Court's decision in Southland is not determinative of the issue before the Court.

Respondent also draws the Court's attention to certain decisions which are inconsistent with that of Garrity, and allow arbitrators to award punitive damages. The Court notes, however, that respondent's reliance on these cases is misplaced. Two of the cases relied upon reflect the positions of the First and Eleventh Circuits, and are therefore not controlling authority. See Raytheon Co. v. Automated Business Systems, Inc., 882 F.2d 6 (1st Cir. 1989); Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378 (11th Cir. 1988). In Dugall International, Inc. v. Sallmetall, No.

84 Cir. 7170 (S.D.N.Y. 1986), Judge John M. Cannella of this Court found Garrity inapplicable to an arbitration whose confirmation was sought under the Federal Arbitration Act. First, the Court notes that all the cases relied upon by respondent, including Dugall, are distinguishable upon closer examination from the circumstances of the instant case, as the arbitration agreements in those cases incorporate the rules of the American Arbitration Association which provide for an arbitration panel's award of "any remedy or relief which is just and equitable and within terms of the agreements of the parties," AAA Rules, Rule 43, including punitive damages. In this case, no such provision was part of the arbitration agreement. Further, to the extent that Dugall can be read as a general rejection of Garrity, this Court

declines to follow it as inconsistent with existing law.

The Second Circuit has implicitly, yet consistently, affirmed the Garrity decision in determining whether punitive damages were appropriate. For example, in John T. Brady & Co. v. Form-Eze Systems, Inc., 623 F.2d 261 (2d Cir.), cert. denied, 449 U.S. 1062 (1980), the court allowed an arbitration panel to grant an award which was not explicitly punitive and was provided for in the arbitration agreement. The Brady Court found that damages not clearly punitive in nature should not be vacated under Garrity. However, the Court implicitly upheld Garrity, stating that "[o]nly where the damages are intended to be punitive should the Court vacate the award." Id. at 264. See also Synergy Gas Co. v. Sasso, 853 F.2d 59 (2d Cir. 1988); Sweeney v. Morganroth, 451

F.Supp. 367 (S.D.N.Y. 1978); O'Driscoll, et al. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1984-85 Transfer Binder] Fed.Sec.L.Rep. (CCH) para. 91, 822 at p. 90, 134 (S.D.N.Y. Oct. 26, 1984). Thus, in light of the precedent set forth by the Second Circuit, the Court concludes that in the instant case, the arbitration panel's award of punitive damages must be vacated.

B. Respondent's Motion to Dismiss for Improper Venue, or to transfer to the Eastern District of Pennsylvania

Respondent has moved to dismiss the action for improper venue, or in the alternative, to transfer the action to the Eastern District of Pennsylvania. Since the cause of action arose in this District and petitioner resides in New York, venue in this District is proper. 28 U.S.C. § 1391(a).

Sections 9, 10, and 11 of the Federal Arbitration Act provide the

procedures for confirming, vacating or modifying an arbitration award. These sections, however, "leave open for interpretation the question of where a dispute over an arbitration award is properly venued when plaintiff and defendant have moved in different forums to confirm and vacate the award." J.V.B. Industries v. Federated Dept. Stores, Inc., 684 F.Supp. 22, 23 (E.D.N.Y. 1988). Therefore, certain factors must be considered before determining whether transfer is appropriate.

Either party in an action brought in federal district court may move to have it transferred to another federal district court where the action could have been brought originally. Such motions for transfer are made pursuant to 28 U.S.C. § 1404(a), which provides:

For the convenience of the parties

> and witnesses, in the interests of justice, a district court may transfer any civil action to any other district or division where it might have been brought.

A motion to transfer pursuant to this section rests with the sound discretion of the Court. Heller Financial, Inc. v. Midwhey Powder Co., 883 F.2d 1286, 1293 (7th cir. 1989); Golconda Mining Corp. v. Herlands, 365 F.2d 856, 857 (2d Cir. 1966). The party requesting transfer "bears the burden of proof and that burden must be carried by a preponderance of the evidence." In Re Manville Forest Products Corp., 896 F.2d 1384, 1390 (2d Cir. 1990); Morales v. Navieras De Puerto Rico, 713 F.Supp. 711, 712 (S.D.N.Y. 1989). A number of factors are relevant to a court's determination of a transfer motion, among which are the convenience of the parties, the ease of access to the sources of proof, the susceptibility of

the witnesses to process, and the interests of justice. Nieves v. American Airlines, 700 F.Supp. 769 (S.D.N.Y. 1988).

The threshold question in a transfer motion is whether the action could have been brought in the district to which transfer is proposed. Wright, Miller & Cooper, Federal Practice and Procedure § 1391. In a diversity action, venue is proper in the judicial district where all defendants reside, where all plaintiffs reside, or where the claim arose. 28 U.S.C. § 1391(a). Respondent resides in the Eastern District of Pennsylvania, and thus venue would be proper in the proposed transferee court.

Respondent has presented the Court with a myriad of reasons why such a transfer is appropriate. Primarily, respondent argues that petitioner agreed to submit to jurisdiction of the

respondent's choice by voluntarily requesting arbitration to decide the instant matter.[2] Although the Court believes that it would have been procedurally preferable for petitioner to have brought this petition to vacate the arbitration award as a counterclaim to respondent's original petition to confirm in the Eastern District of Pennsylvania, the Court is unconvinced that this is a sufficient reason for transfer. Respondent maintains that, according to recent Second Circuit decisions "where there are two competing lawsuits, the first should have

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[2] Rule 628(a) of the Arbitration Rules of the New York Stock Exchange provides:

> All awards shall be in writing and signed by a majority of the arbitrators or in such manner as is required by law. Such awards may be entered as a judgment in any court of competent jurisdiction.

priority, absent the showing of a balance of convenience in favor of the second action, or unless there are special circumstances which justify giving priority to the second." Fort Howard Paper Co. v. William D. Witter, Inc., 787 F.2d 784, 790 (2d Cir. 1987). However, this Court has determined on a number of occasions, that venue is not necessarily dictated by "the race" to the Courthouse. Great American Insurance co., v. Houston General Insurance Co., 735 F.Supp. 581, 585-86 (S.D.N.Y. 1990). See also Motion Picture Laboratory Technicians Local 780 v. McGregor & Werner, Inc., 804 F.2d 16 (2d Cir. 1986); J.V.B. Industries, Inc., supra. Moreover, the Federal Arbitration Act provides for a motion to vacate in the district where the award was rendered. Since the award was made in this district, venue is proper here.

Respondent further argues that, since there are no witnesses involved, the convenience of the parties is of major concern. Transfer is appropriate, respondent maintains, because petitioner has far greater financial size and capacity, and thus, should be the party to bear the cost of suit in a distant forum. It is true that a court can consider the relative means of the parties in reaching a decision on a motion for transfer. See, e.g., Goldstein v. Rusco Industries, Inc., 351 F.Supp. 1314, 1318 (E.D.N.Y. 1972). However, as respondent emphasizes, "this is the type of matter that is going to be heard on briefs and notes of testimony alone," and thus, the Court concludes that pursuing the instant action in this District would not be unduly burdensome. Given that the documents have already been filed in

this Court, the balance of convenience weighs in favor of retaining the action in this District. Furthermore, respondent's argument reduces to a desire to shift the cost of pursuing a distant action to petitioner. It is elemental that a mere shifting of inconveniences is not grounds for transfer. Finkielstain v. Seidel, 692 F.Supp. 1497, 1509-10 (S.D.N.Y. 1988), aff'd in part and rev'd in part, 857 F.2d 893 (2d Cir. 1988).

Finally, respondent maintains that transfer is necessary since respondent lives in Pennsylvania and conducted business for Fahnestock in Pennsylvania. In consideration of all factors involved in the present case, however, the Court concludes that the balance weighs in favor of retaining this action in this District. Respondent was based in New York, as

well as in Pennsylvania, in connection with his business with Fahnestock. Petitioner's principal place of business is in New York, and the arbitration took place in New York. The action's only substantial connection with Pennsylvania is that respondent resides there.

Thus, respondent has failed to meet his burden of persuading the Court that transfer is warranted. Accordingly, respondent's motions to dismiss for improper venue and to transfer the instant action to the Eastern District of Pennsylvania are denied.

CONCLUSION

For the reasons set forth above, petitioner's motion to vacate the arbitrator's award for defamation is denied. Petitioner's motion to vacate the arbitrator's award of punitive damages is granted. Respondent's motion to dismiss and to transfer to the

Eastern District of Pennsylvania are denied.

SO ORDERED

Dated: August 22, 1990
New York, New York

/s/ Peter K. Leisure
U.S.D.J.